MILITARY SURVIVOR BENEFITS: ANALYSIS OF PROPOSED CHANGES

Staff Working Paper
July 1985

The Congress of the United States
Congressional Budget Office

J932-31

PREFACE

Although it is a small program in comparison to the overall military retirement system, the Survivor Benefit Plan (SBP) for military retirees has been the source of continued Congressional attention and review since the program was begun in 1953. The present SBP, as initially enacted in 1972 and modified in 1980, provides survivor benefits in concert with Social Security, with the cost of the program being borne jointly by retirees and the government.

Declining retiree participation rates in SBP and perceived inequities in the program led the Congress in 1984 to enact prospective changes in the Social Security integration provisions. At the same time, the Military Personnel and Compensation Subcommittee of the House Committee on Armed Services asked CBO to evaluate some more fundamental changes in the structure of SBP. Those proposed changes, incorporated in the House version of the Fiscal Year 1986 Department of Defense Authorization Bill, are the subject of this CBO staff working paper. In keeping with CBO's mandate to provide impartial and objective analysis, this report makes no recommendations.

This study was conducted by Ed Shephard of CBO's National Security Division under the general supervision of Robert Hale and Neil Singer. The analysis benefited from the extensive assistance of the Office of the Department of Defense Actuary and its head, Ms. Toni Hustead. (Outside assistance implies no responsibility for the study, which rests with CBO.) Within CBO, Julia Doherty and Barbara Hollinshead of the Budget Analysis Division and Christian Frederiksen of NSD provided help and comments. The paper was edited by Francis Pierce. G. William Darr prepared the manuscript for release.

July 1985

CHAPTER I. INTRODUCTION AND SUMMARY

One of the principal elements of the estate program provided to military personnel is the Survivor Benefit Plan (SBP). Provisions allowing active-duty military retirees to designate portions of their retired pay for their survivors have been in effect since 1953, when the Uniformed Services Contingency Option Plan (renamed in 1961 the Retired Serviceman's Family Protection Plan (RSFPP)) was enacted. In an effort to make participation in a survivor benefit program more attractive, in 1972 the Congress replaced the original program with the current Survivor Benefit Plan. A companion program, the Reserve Component Survivor Benefit Plan (RCSBP), was subsequently enacted in 1978. 1/

A hallmark of the new Survivor Benefit Plan was the concept that the government and the military retiree should share the cost of providing income security for the retiree's survivors, with members paying an average of 60 percent of the costs. Lower-ranking members were required to pay less. It was expected by the Department of Defense and the Congress that one result of the survivor benefit subsidy would be a participation rate perhaps as high as 85 percent.

As enacted, however, SBP contained several provisions that were viewed as inequitable and that reduced the value of the plan for retirees and their survivors. One such provision was the Social Security offset, which reduced survivors' military annuities once they began to receive Social Security benefits. As a consequence, participation rates declined under SBP following its initial enactment and led the Congress again to modify SBP in 1980. Chief among the 1980 modifications was a limitation on the maximum amount of the Social Security offset. 2/

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1. RCSBP gives Reserve retirees the opportunity to ensure an annuity for their survivors in the event that they die after completing 20 years of creditable service but before reaching age 60, when they begin receiving retired pay and can elect coverage under SBP. The additional cost of providing coverage for the pre-age 60 years is not subsidized by the government.

2. See Congressional Budget Office, Analysis of the Military Survivor Benefit Plan (Staff Working Paper, March 1981).

Nonetheless, a review of SBP by the Fifth Quadrennial Review of Military Compensation in 1984 concluded that--despite the 1980 revisions--the members' share of SBP costs had risen to 72 percent (for members who entered service in 1984). 3/ At the same time, the Congress enacted a modification of SBP known as the Thurmond Amendment. This provision, scheduled to take effect at the beginning of fiscal year 1986, would reduce the Social Security offset to the extent that Social Security benefits were earned by a survivor's own labor force experience rather than by his or her status as a survivor of a military retiree.

Continuing concern about SBP's low participation rates (which stood at 52 percent in 1984), its complexity, and its cost-sharing ratio led the Military Personnel and Compensation Subcommittee of the House Armed Services Committee to request that CBO review the current Survivor Benefit plan (SBP) and selected alternatives. 4/ In particular, the subcommittee asked CBO to analyze an alternative that would substitute a two-tier benefit plan for the current SBP, eliminating the rationale for any Social Security offset.

In subsequent action, the House version of the fiscal year 1986 Department of Defense (DoD) authorization bill proposed several changes to SBP designed to make the program fairer and more attractive to retirees. These changes included:

- Replacement of the current SBP with a two-tier benefit plan, and elimination of the Social Security offset;
- Indexing the minimum insurance amount to the change in military basic pay;
- Requiring spousal concurrence in retirees' decisions to insure less than the maximum retired pay under SBP;
- Permitting participating members to opt for the resumption of SBP coverage upon remarriage; and

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3. Department of Defense, Fifth Quadrennial Review of Military Compensation, Vol. II: Uniformed Services Survivor Benefits Program (December 1983), p. IV-19.

4. Office of the Actuary, Defense Manpower Data Center, DoD Statistical Report on the Military Retirement System, Fiscal Year 1984 (1984), p. 214.

- Several other provisions improving equity for particular groups of survivors.

CBO's analysis of the House changes indicates that they would maintain the members' share of SBP costs at 60 percent, quite close to the target level identified by the Congress upon initial enactment of SBP. Accrual charges, the amount of funds that must be set aside in current military budgets to pay for future benefits, would roughly double over current levels but would remain a small fraction of the overall cost of the military retirement system. Near-term federal outlays would actually decrease, as more members opted for participation and thus paid their contributions into the military retirement trust fund in anticipation of future benefits.

Of the provisions of the House plan, the indexing feature was found by CBO to have the greatest effect upon the cost-sharing ratio. The spousal concurrence provision is the feature most responsible for both the increase in accrual charges and the near-term outlay savings. CBO's estimate of the cost of spousal concurrence and the remarriage coverage option is subject to considerable uncertainty, however, because there is little evidence to suggest how these provisions would affect behavior.

CHAPTER II. KEY PROVISIONS OF THE CURRENT SYSTEM

Under the Survivor Benefit Plan, military retirees can elect to use their retirement benefits to provide annuities to designated survivors. A retiring member who elects to provide such an annuity is subject to a monthly reduction in retired pay. Upon the death of the retiree, the survivor begins to receive the annuity. Congressional intent has been to have participating members and the government share in the funding of this program, with the members paying approximately 60 percent of the costs. For a cohort entering the military in fiscal year 1986, the entry-age normal cost calculations done by CBO indicate that the members' share of costs for the program in effect during fiscal year 1985 would be 73 percent.

Electing Coverage

At the time of retirement, a member makes an irrevocable decision about participating in SBP. A retiree may insure up to 100 percent of retired pay (with the survivor receiving 55 percent of the insured amount upon the death of the retiree). Participants must insure either a minimum of $300 per month or 100 percent of retired pay if that pay is less than $300 per month.

Deduction from Retired Pay

To cover a spouse, the monthly retired pay of a participating member is reduced to pay for the member's share of the cost of providing the annuity. The amount of the monthly deduction is equal to 2.5 cents per dollar covered for the first $300 per month that is insured, and 10 cents per dollar for each dollar of coverage in excess of $300. This reduction is made in any month that a current or subsequent spouse is present. When the retired pay of a participating member is increased, the amount of the monthly deduction is increased by an equal percentage.

Instead of providing for an annuity that would go to a surviving spouse, a retiree could elect to cover a spouse and a child, a child only, or someone with an insurable interest in the retiree (including a former spouse). These types of coverage vary from the spouse-only coverage in the way that the benefits and/or deductions are calculated. 1/ Because 96 percent of the re-

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1. According to the Fifth Quadrennial Review of Military Compensation report on SBP, the additional cost of coverage for a child (or children)

tirees on the SBP rolls currently elect either spouse-only (77 percent) or spouse-and-child (19 percent), which differs only slightly from spouse-only coverage, this study will focus its discussion of deduction and benefit calculations on spouse-only coverage. 2/

Payments to Survivors

Upon the death of a participating retiree, the surviving spouse begins to receive a monthly annuity equal to 55 percent of insured retired pay. At age 62 the survivor's annuity is reduced (up to a maximum of 40 percent) by the amount of the Social Security benefit that would be received if it were based solely on military service that occurred on or after January 1, 1957 (when military personnel first became covered under Social Security). For widows who are under age 62 and have one dependent child, an offset equal to 75 percent of the post-62 Social Security benefit is deducted from the survivor annuity.

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under spouse-and-child coverage is less than 1 percent of the insured amount. This charge, which does not vary by the number of children, is determined actuarially on the basis of the age of the youngest child and is discontinued when all dependent children in a household reach age 18 (age 22 if still in school). In the event that the spouse dies, eligibility for and payment of benefits will continue until the youngest child is no longer considered to be a dependent. Like the additional cost of coverage for a child covered with a spouse, child-only coverage costs less than 1 percent of the insured amount. Pay reductions and benefit payments occur only when the covered child is considered a dependent (according to age and student status).

For a person who has a financial interest in the retiree, the member can provide coverage to that person by electing to insure 100 percent of retired pay (the only amount permitted under the insurable interest provision of SBP). Deductions from pay are equal to 10 percent of the insured amount (plus an additional 5 percent for each five years that the beneficiary is younger than the retiree). This annuity is equal to 46.8 percent of the insured amount and is not subject to any offsets. See Department of Defense, Fifth Quadrennial Review of Military Compensation, Vol. II: Uniformed Services Survivor Benefits Program (December 1983), pp. IV-9-10.

2. See Office of the Actuary, Defense Manpower Data Center, DoD Statistical Report on the Military Retirement System, Fiscal Year 1984 (1984), pp. 222-223.

Social Security Offset

Currently the Social Security offset is calculated without regard to any Social Security benefit that the survivor may have earned from his or her own work. 3/ Calculated in this way, the member/government cost-sharing ratio for a cohort entering service in fiscal year 1986 is estimated by CBO to be 73/27. Included in the 1985 DoD authorization bill, however, was a provision (the Thurmond Amendment) to reduce the Social Security offset to the extent that Social Security is based on the survivor's own earnings. This provision is scheduled to go into effect in fiscal year 1986. The exact method for implementing this change is yet to be ruled on by the Comptroller General.

Consistent with legislative intent, a "narrow" interpretation of the Thurmond Amendment would eliminate the entire offset for survivors who are receiving a Social Security benefit based entirely on their own earnings (that is, whose own earned Social Security benefits are greater than, or equal to, the Social Security survivors' benefits to which they would otherwise be entitled). CBO estimates that this interpretation would affect 10 percent of those receiving military survivors' benefits. Relative to the law in effect in fiscal year 1985, the member/government cost-sharing ratio for a cohort entering in fiscal year 1986 would change from 73/27 to 70/30. CBO estimates that the SBP accrual payment for fiscal year 1986 would need to increase by $36 million.

In addition to eliminating the Social Security offset for survivors affected by the narrow interpretation, a "broad" interpretation (consistent with some interpretations of the statutory language) would reduce the Social Security offset proportionately for survivors for whom any part of their Social Security benefit is based on their own earnings. Relative to fiscal year 1985 law, CBO estimates that this interpretation would reduce Social Security offsets by an average of 30 percent. The member/government cost-sharing ratio for a cohort entering service in fiscal year 1986 would change from 73/27 to 64/36. CBO estimates that the broad interpretation of the fiscal year 1986 law would raise the accrual payment in fiscal year 1986 by $108 million over that which would be required under fiscal year 1985 law.

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3. For individuals currently receiving reduced Social Security survivors' benefits because they are working, the size of the Social Security offset under SBP is reduced.

CHAPTER III. HOUSE MODIFICATION OF SBP

The House version of the 1986 DoD authorization bill proposed several changes to the current Survivor Benefit Plan in an effort to make the program fairer and more attractive to retirees.

Indexing

The House would "index" the $300 base in the contribution formula to increases in basic pay. Thus, the $300 contribution base amount would increase each time military basic pay increased, and by the same percentage. This change would prevent wage growth from increasing the cost of insuring any particular fraction of retired pay. The intent of this provision was to keep the members' share of SBP costs the same for future retirees as it is for those now retiring. Indexing would achieve this goal by making the same fraction of the retired pay of members who retire in future years subject to the lower 2.5 percent deduction as is the case for military personnel who retire today.

Two Tiers of Benefits

To remove the complexity and uncertainty surrounding SBP's integration with Social Security, the House plan would eliminate the Social Security offset and institute a two-tier plan that pays 55 percent of the insured amount when the survivor is less than 62 years old and 35 percent after the survivor reaches age 62. The two-tier benefit structure would replace a system that is already complex and that will become more so. Under the SBP provisions in effect in fiscal year 1985, the Social Security offset that survivors face varies with members' earnings histories and the amount of retired pay they elect to insure. The Thurmond Amendment, which is scheduled to take effect in fiscal year 1986, would mean that in some cases survivors of retirees who had the same retired pay and who had selected the same amount of SBP coverage would be subject to different Social Security offsets because of differences in the survivors' employment histories.

Spousal Consent

The House plan would give spouses veto power over a decision by a retiree to elect less than maximum SBP coverage. This change parallels provisions in ERISA laws and the civil service retirement system.

Remarriage Coverage

To bring additional flexibility to SBP, the House plan would make the resumption of SBP coverage optional upon a participating member's remarriage. Currently, the new spouse of an SBP participant who remarried after having become divorced or widowed is automatically covered. Accompanying the automatic coverage of a previous participant's new spouse is an automatic SBP deduction taken from the member's retired pay in any month that a spouse is present.

Other Changes

In addition to the provisions listed above, a number of other changes were proposed. These changes, which do not significantly affect costs, include:

- Allowing a member to provide coverage to both a former spouse and children born in that marriage;
- Providing survivor benefits to dependents of officers who died on active duty after serving at least twenty years, but were not yet retirement eligible because of earlier enlisted service;
- Allowing SBP widows who remarry after age 60 and lose Dependency and Indemnity Compensation benefits to repay previously refunded SBP deductions (to restore SBP benefits to their original level) on an installment rather than lump-sum basis; 1/ and
- Providing annuities to the widows of Reservists who, before making a decision on electing survivor coverage, die during the 90-day notification period that follows the completion of their twenty years of creditable service.

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1. Dependency and Indemnity Compensation is an annuity paid to survivors of service members who die in the service while performing their duties, or after leaving the service as a result of a service-connected disability. If death occurs after retirement and Dependency and Indemnity Compensation is subsequently awarded, monthly SBP benefits are reduced by an equal amount. This reduction in SBP benefits is accompanied by a refund of SBP deductions from retired pay that corresponds to the amount by which the SBP benefits are reduced.

Finally, current survivors and future survivors of current retirees are protected in the event that the provisions in effect during fiscal year 1985 are more generous than those that would be enacted in the House authorization bill.

CHAPTER IV. COSTS AND COST SHARING UNDER THE HOUSE PROPOSALS

Inasmuch as SBP is a component of the overall military retirement system, budgetary authority for SBP is funded on an accrual basis even though actual benefits appear as current federal outlays. In consequence, two measures of SBP cost are relevant when modification of the program is under consideration: the fiscal year 1986 accrual cost, and the near-term outlay changes that would result from changing SBP. 1/ Cost sharing, which measures the fraction of total benefits paid by the member, is also an important measure.

CBO's cost estimates rest on several key assumptions about participation (see Appendix). Of particular importance is the assumption that the spousal concurrence provision in the House proposal would lead to participation by 50 percent of those married retirees who do not now elect coverage. Because there is little evidence to determine how this provision would affect coverage, CBO's estimates are subject to considerable uncertainty.

The effects of each of the elements of the House plan upon these various measures are detailed in the remainder of this chapter.

Cost-sharing Comparisons

Table 1 shows cost-sharing ratios for SBP under various alternatives. The House plan would lower the member/government cost-sharing ratio from 73/27 estimated for a cohort entering service in 1986 (using the law in effect during fiscal year 1985) to approximately 60/40. 2/ The indexing

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1. Under accrual costing an entering cohort of accessions is tracked through military service and retirement. Also tracked from the point of initial eligibility until death or disqualification are survivors receiving SBP benefits. The normal cost percentage for the retirement system is then determined by the ratio of the present discounted value (PDV) of net retirement costs to the PDV of basic pay received by that cohort. The cost-sharing ratio for SBP is calculated similarly. The share of costs borne by members is the ratio of the PDV of members' deductions to the PDV of benefits paid to their survivors.

2. Under current law, either the narrow or the broad interpretation of the Thurmond Amendment will be in effect in fiscal year 1986. Either

TABLE 1. HOUSE SBP COST-SHARING RATIOS UNDER VARIOUS ALTERNATIVES (For a cohort entering in fiscal year 1986)

	Members' Share (Percent)
Fiscal Year 1985 Law	73
Fiscal Year 1986 Law (Narrowly interpreted) a/	70
Fiscal Year 1986 Law (Broadly interpreted) b/	64
Basic Two-Tier Plan c/	69
Basic "Wage-Indexed" House Plan c/ d/	56
"Wage-Indexed" House Plan With Veto Power and Optional Remarriage Coverage c/ d/ e/ f/	60

a. Average Social Security offsets are assumed to be 10 percent lower than under fiscal year 1985 law.
b. Average Social Security offsets are assumed to be 30 percent lower than under fiscal year 1985 law.
c. Two-tiered plan (55 percent before age 62 and 35 percent after age 62). No Social Security offset. No indexing.
d. The $300 base in the member's deduction formula is indexed to changes in basic pay.
e. One-half of all retirees are assumed to decline remarriage coverage.
f. Beginning in fiscal year 1986, one-half of the married members who would otherwise decline SBP coverage are assumed to elect SBP. In addition, the average percentage of retired pay covered under SBP is assumed to increase to include one-half of the amount not currently covered.

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interpretation would change the members' share of SBP cost: the narrow interpretation would lower it to 70 percent, and the broad interpretation to 64. The House plan would obviate the basis for the Thurmond Amendment by eliminating the explicit Social Security offset.

feature of the House plan, which is responsible for most of the reduction in the members' share, is also the provision that would maintain the share at 60 percent for future cohorts of retirees.

The other alternatives in the table display the member cost shares that would result from variations on either the current system or the House plan. Substituting the House two-tier plan without the indexing provision would not affect members' shares greatly, because most survivors would receive closely similar benefits under either the fiscal year 1985 law or the House plan. Other components of the full unindexed House plan also do not alter members' shares substantially.

Accrual Costs

Accrual charges approximate long-run costs and thus are the best measure for judging the cost of the House proposal, since present commitments made to retirees are difficult to change later. Table 2 shows, for fiscal years 1986-1990, the additional accrual costs that would be necessary to fund the House's SBP changes. CBO estimates that these changes would increase the normal cost percentage by 0.68 percentage points. To fund these changes, the fiscal year 1986 accrual cost would need to increase by $242 million from a baseline that uses a narrow interpretation of the Thurmond Amendment. (If the broad interpretation of the Thurmond Amendment is chosen, the cost increase under the House plan would be $170 million.)

The estimated net accrual cost of the baseline would be $227 million in fiscal year 1986. The proportional increase in SBP accrual cost over the fiscal year 1986 baseline thus would be 107 percent. It should be noted, however, that the absolute amount of the increase is modest relative to the total cost of military retirement. The overall accrual cost of the military retirement system is $18.2 billion in fiscal year 1986; the baseline SBP cost is thus only 1.2 percent of the cost of the total system. 3/

Accrual costs are also shown in Table 2 for the alternative SBP changes included in the analysis of the cost-sharing ratio. By far the most costly component of the House changes is the provision requiring spousal concurrence. As discussed earlier in this chapter, CBO's estimate of the cost of this provision and the remarriage coverage option is subject to considerable uncertainty because there is little evidence to determine how these provisions would affect behavior.

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3. The Budget of the United States Government, Fiscal Year 1986, Appendix, p. I-H14.

TABLE 2. NET CHANGES IN DoD ACCRUAL CHARGES FOR SBP ALTERNATIVES COMPARED WITH "NARROW" INTERPRETATION OF FISCAL YEAR 1986 LAW (Budget authority and outlays, by fiscal year, in millions of current dollars) a/

	1986	1987	1988	1989	1990	Total 1986-1990
Basic Plan b/	7	7	8	9	9	40
Wage-Indexed Plan b/ c/	110	116	125	135	143	629
Wage-Indexed Plan With Veto Power and Optional Remarriage Coverage b/ c/ d/ e/ f/	242	253	274	295	313	1,377

a. Average Social Security offsets are assumed to be 10 percent lower than under fiscal year 1985 law.
b. Two-tiered plan (55 percent before age 62 and 35 percent after age 62). No Social Security offset.
c. The $300 base in the member's deduction formula is indexed to changes in basic pay.
d. One-half of all retirees are assumed to decline remarriage coverage.
e. Beginning in fiscal year 1986, one-half of the married members who would otherwise decline SBP coverage are assumed to elect SBP. In addition, the average percentage of retired pay covered under SBP is assumed to increase to include one-half of the amount not currently covered.
f. The normal cost percentage increases by 0.68 percentage points.

Outlay Effects

Although accrual charges indicate the amounts that must be set aside to cover higher future payments to beneficiaries, they do not show the actual outlays that the federal government must make for today's payments. Because members' contributions into the military retirement trust fund would rise for many years before these higher future benefits would be paid to

TABLE 3. CHANGES IN NET OUTLAYS BY GOVERNMENT FOR SBP ALTERNATIVES COMPARED WITH "NARROW" INTERPRETATION OF FISCAL YEAR 1986 LAW (By fiscal year, in millions of current dollars) a/

	1986	1987	1988	1989	1990	Total 1986-1990
Basic Plan b/	12	15	18	22	25	92
Wage-Indexed House Plan b/ c/	12	15	19	24	27	97
Wage Indexed House Plan With Veto Power and Optional Remarriage Coverage b/ c/ d/ e/	-5	-15	-25	-35	-50	-130

a. Average Social Security offsets are assumed to be 10 percent lower than under fiscal year 1985 law.
b. Two-tiered plan (55 percent before age 62 and 35 percent after age 62). No Social Security offset.
c. The $300 base in the member's deduction formula is indexed to changes in basic pay.
d. One-half of all retirees are assumed to decline remarriage coverage.
e. Beginning in fiscal year 1986, one-half of the married members who would otherwise decline SBP coverage are assumed to elect SBP. In addition, the average percentage of retired pay covered under SBP is assumed to increase to include one-half of the amount not currently covered.

survivors, the outlay changes associated with the House plan would actually reduce the costs to the government in the near term. Table 3 shows, for fiscal years 1986-1990, the additional outlays that would be required under the House's SBP changes.

CBO's estimates of the outlay effects of the House provisions are quite different from the estimated accrual costs. The spousal concurrence feature, which is the most costly element of the House plan in terms of accrual charges, would actually generate the largest estimated outlay savings to the government over the next five years. The reason is that more

retirees are assumed to participate. Since total near-term contributions into the military retirement trust fund would rise, net outlays from the fund would decline. Eventually, of course, outlays would increase as these participants' survivors began to receive benefits.

APPENDIX

APPENDIX. ASSUMPTIONS

Long-run Economic Assumptions

The long-run CPI was obtained by extending CBO's five-year forecast indefinitely. The wage and interest rate assumptions were derived from the long-run CPI using the DoD Office of the Actuary's long-run assumptions (those employed to determine the fiscal year 1986 normal cost percentage).

Inflation:	4.2 percent
Wage growth	4.7 percent (0.5 percent real)
Interest rate:	5.2 percent (1 percent real)

Actuarial Assumptions

The following rates were obtained from the DoD Office of the Actuary:

mortality;
divorce;
remarriage; and
SBP widows with one child

SBP Participation and Coverage

Based on data for fiscal year 1983 retirees obtained from the DoD Office of the Actuary: 1/

	Percent Participation	Percent of Gross Retired Pay Covered
Enlisted Nondisability, excluding Reserves	41	71
Officer Nondisability, excluding Reserves	65	69
Disabled Enlisted	38	89
Disabled Officers	49	85
Reserve Enlisted	84	98
Reserve Officers	85	97

1. As the study neared completion, data from fiscal year 1984 retirees became available. However, these data were not substantially different from fiscal year 1983 data.